THE DISTRICT LINE® by BILL GOLD

Cuban Ransom Gifts Were For Real

THIS IS A Nation in which almost every adult pays income taxes. Most of us have had long experience at wrestling with long forms and short forms. And in the process we've learned a little bit about our tax laws. But not very much, really. The tax structure is so complicated that even Philadelphia lawyers have to come to Washington for help. So what chance has a mere layman? We harbor tax misconceptions by the dozen, especially about tax problems that few of us ever have to face.


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A recent example of such misconceptions is the rumor that business firms which chipped in millions of dollars to ransom those Cuban prisoners did so because "it didn't cost them a cent—they deducted the entire cost from their income taxes." This was followed by the even more lively report that the businessmen actually made a profit on their gifts.

It was explained that one who gives cash can deduct only the amount of the cash. But one who gives merchandise can deduct the usual selling price of the merchandise—which, for a manufacturer, includes both his cost and his profit on the sale of such an item.

A layman who hears this may assume that a company can spend (let us say) $1 million to produce some merchandise, and then deduct $1.5 million from its tax bill because the goods normally would have sold for $1.5 million.

However, such an assumption would be incorrect. The $1.5 million would not be subtracted from the final tax bill, but from the profit figures on which the tax is computed.

For a company that earns and pays taxes on $30 million a year, it would work like this:

The company would pay roughly half (the rate goes to 52 per cent) of its income in taxes—in this case about $15 million. However, if the company gave to charity merchandise worth $1 million at cost and $1.5 million at usual selling prices, it could deduct $1.5 million from its $30 million in taxable income. The tax would therefore be paid on $28.5 million, and would come to about $14.25 million.

Now analyze what happened. Did the company make a gift without spending a cent? It did not. It spent $1 million to do $1.5 million worth of good for charity, and in the process it recaptured $750,000 in tax savings. The net out-of-pocket cost to the company was therefore a quarter of a million dollars.

If you like to play around with figures, you can try some examples with varying profit margins. You'll find that if you experiment with a selling price that is double the cost of production, your mythical manufacturer will indeed be able to contribute to charity without taking anything out of his pocket. And if you try a selling price that is more than double the cost, the manufacturer actually shows a profit on his gifts.

In reality, however, you will seldom encounter such high profit margins when a manufacturer is selling to wholesalers (or governments) in million-dollar quantities.

What actually happened in the Cuban prisoner ransom was that many American firms responded wholly unselfishly, yet found themselves criticized for it, and their motives questioned.

Mitchell Rogovin is an assistant to IRS Commissioner Mortimer M. Caplin. He spent many weeks working on the Cuban deal. Asked about reported profiteering, he said to me:

"Don't you believe it. These men weren't looking for an advantageous business deal, they were responding to a humanitarian appeal. One firm had already given its allowable maximum of 5 per cent for the year, but they didn't hesitate for an instant. They gave $500,000 on which they won't get a penny of tax benefit. Another firm that found itself with a profit at the end of the transaction immediately gave the money away to a charitable foundation. It is ironic that men who gave so generously should be criticized for it."